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NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

B-212301

JULY 21, 1983

The Honorable Joseph P. Addabbo
Chairman, Subcommittee on Defense
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

Subject: Savings on the CVN-71 and Termination Costs
of the CVN-72 and -73 Nuclear Aircraft
Carriers (GAO/NSIAD-83-16)

In response to your April 8, 1983, letter and subsequent discussions with your office, we have looked into the following aspects of the Navy's programs to acquire the CVN-71, -72, and -73 nuclear aircraft carriers. As agreed with your office, we examined the reasonableness of (1) the Navy's estimated savings of \$74 million on the CVN-71 as a result of awarding a contract for the CVN-72 and -73 and (2) Navy officials' estimated costs to terminate the contract for the CVN-72 and -73.

The Navy's savings estimate of \$74 million on construction of the nuclear aircraft carrier CVN-71 was prepared nearly 2 years ago and has not been updated. However, the estimate still appears reasonable if the current delivery schedule is met as expected.

The Navy has not made a detailed analysis of costs to terminate the contract for the CVN-72 and -73. Therefore, we were unable to verify estimates of termination costs made by Navy officials.

Details on each of these observations are provided below.

ESTIMATED SAVINGS
ON THE CVN-71

Your first question dealing with the Navy's estimated savings of \$74 million on the CVN-71 had two parts. First, your letter stated that the Navy has claimed that by awarding a contract for the CVN-72 and -73 carriers, savings amounting to

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about \$74 million would also be realized on the CVN-71. Second, since the CVN-71 is already under construction, you asked us to determine whether it is reasonable for the Congress to reduce the Navy's obligational authority by that amount.

Savings of \$74 million on the CVN-71 not predicated on the CVN-72 and -73 contract

Regarding the first part of your question, the Navy informed us that the expected \$74 million savings on the construction of CVN-71 was not attributable to the award of a contract for CVN-72 and -73. The Business Manager, Aircraft Carrier Ship Acquisition Project Office, said that the Navy believed Newport News Shipbuilding and Dry Dock Company, the contractor for all three carriers, could have achieved this saving even if a contract for CVN-72 and -73 had not been awarded. The manager pointed out that the \$74 million savings estimate was calculated in late 1981, a year before the award of the contract for CVN-72 and -73. At that time, the Navy negotiated a special contract incentive with Newport News Shipbuilding and Dry Dock Company to deliver the CVN-71 by December 31, 1986--14 months earlier than the February 1988 delivery date specified in the original contract. The \$74 million savings estimate was based on the earlier delivery schedule as follows.

	(millions)
Reduced escalation costs	\$ 53.0
Reduction of other time-related costs	<u>42.0</u>
Gross total	\$ <u>95.0</u>
Less: Value of special contract incentive	<u>-21.2</u>
Total savings	<u>\$ 73.8</u>

The \$53 million reduced escalation costs results from the 14-month shorter period of time that economic escalation occurs. This cost reduction was calculated in December 1981 using then current economic projections.

Similarly, the Navy expected that time-related costs of \$3 million each month, or \$42 million in total, would be avoided by the 14-month early delivery. Time related costs

included guard services, utilities, maintenance, and other services that would be required as long as the ship remained in the contractor's yard.

From the projected gross savings to the government of \$95 million, the Navy subtracted \$21.2 million--the amount of the special incentive to the contractor if CVN-71 is delivered 14 months early. The incentive will be reduced proportionately by \$49,882 each day for delivery after December 31, 1986, with no incentive to be paid for delivery on the required delivery date in February 1988.

Although the Navy believes the \$74 million could have been saved without the contract for the two additional carriers, the carrier Business Manager said that the award of the contract increased the Navy's confidence that the earlier delivery date for the CVN-71 would be met. That is, under the contract for CVN-72 and -73, Newport News Shipbuilding and Dry Dock Company agreed to a delivery date of December 1989 for the CVN-72. Based on statements to the Navy by the contractor that it requires 30 months between delivery of CVN-71 and -72, the CVN-71 would have to be delivered by around June 1987 to meet the December 1989 contractually required delivery date for the CVN-72. Therefore, the February 1988 contractually required delivery date for CVN-71 will have to be improved by at least 8 months if the schedule for the CVN-72 is to be met.

The Navy is also confident that the contractor will be able to pick up the additional 6-month early delivery to achieve the total 14-month time savings for the CVN-71. This is because the contractor is using its new North Yard facility for the first time to build a carrier. That facility, constructed to build liquified natural gas tankers, contains equipment and other capabilities which enables the contractor to build carriers faster than in the past.

In summary, the Navy's estimated savings of about \$74 million on the CVN-71 appears reasonable if the incentive delivery date of December 31, 1986, is met. The carrier Project Office informed us that, with about 53 percent of construction completed, the CVN-71 is on schedule to meet that date.

Possibility of reducing the
Navy's obligational authority

Your letter asked whether it was possible for the Congress to reduce the obligation authority for the CVN-71 by an amount equal to the \$74 million expected savings. In our opinion, the

basis for such a budget cut at this time would be very speculative. That is, if such a cut was made it would indicate that the Congress is confident, as is the Navy, that a 14-month early delivery of the CVN-71 will, in fact, occur. However, as you know, if the expected savings on the CVN-71 do not materialize, any funds deleted now could still be required in the future to complete the ship's construction.

In addition, the Navy believes that it has already factored in the major portion of the \$74 million projected savings in its estimate for the CVN-71. That is, officials in the carrier Project Office informed us that the Navy has reduced its budget for escalation on the CVN-71 by \$47.7 million¹ to reflect the 14-month earlier delivery date of December 31, 1986. The remaining portion of the projected savings (about \$20 to \$25 million after deducting the special contract incentive of \$21.2 million and depending upon the escalation indexes used) represent time-related costs which also depend on the 14-month earlier delivery date and are therefore very speculative in terms of being candidates for budget cuts.

TERMINATION COSTS OF THE CVN-72 AND -73

In discussions with your office, we were asked to verify information provided during recent testimony by the Secretary of the Navy and the Assistant Secretary of the Navy for Shipbuilding and Logistics regarding probable costs if the contract for the CVN-72 and -73 was terminated.

The Secretary testified before your Subcommittee on March 1, 1983, relative to the CVN-72 and -73. In a subsequent written response to a question at the hearing, the Secretary said that the cost to terminate procurement of these carriers was impossible to determine but that it would amount to billions of dollars and would result in years of claims and counterclaim litigation. The Assistant Secretary for Shipbuilding and Logistics testified on April 20, 1983, that a reasonable estimate of the cost to terminate procurement of one of the two carriers would be in excess of \$1 billion.

We found that the Navy has made no detailed analysis of what it would cost to terminate procurement of both the CVN-72

¹The \$47.7 million differs from the \$53 million included in the estimated \$74 million savings because the Navy used different escalation indexes.

and -73 or only one of the two ships. Therefore, we were unable to verify the estimates made by either the Secretary or the Assistant Secretary. Without such an analysis, we believe all estimates of termination costs must be considered conjectural.

We did note, however, that the Navy prepared a discussion paper which addresses, among other things, the issue of the probable cost of terminating the procurement of the CVN-72 or the CVN-72 and -73. The summary in that document stated, in part:

"Due to the literally hundreds of contracts and subcontracts involved, the Navy really doesn't know what it would cost to cancel one or both of the CVN's. We do know it would be enormous, probably in excess of \$1.5 billion to cancel one. We also know it would cause at least a decade of claim and counterclaim litigation."

Although the discussion paper does not constitute a detailed analysis of probable termination costs, it is the Navy's best available "estimate" of such costs.

We discussed the two matters of concern to you with the Navy's Aircraft Carrier Ship Acquisition Project, the Naval Sea Systems Command and the Office of the Assistant Secretary of the Navy for Shipbuilding and Logistics. We obtained documentation prepared by the Office of the Secretary of Defense and by various offices in the Navy and reviewed unpublished transcripts of hearings held before the Subcommittee. We also reviewed documentation in our files obtained or prepared in connection with our prior reviews pertaining to nuclear aircraft carriers. ²

²The following GAO reports and correspondence have been provided to your staff:

Request to Fully Fund Two Nuclear Aircraft Carriers in Fiscal Year 1983 (MASAD-82-27, dated March 26, 1982).

Follow-up of the Navy's Estimated Cost Avoidance/Earlier Delivery for Nimitz Class Aircraft Carriers (GAO/PLRD-83-54, dated March 1, 1983).

Letter to Senator Jeff Bingaman dated May 11, 1983, relative to termination costs of the program to acquire the CVN-72 and -73.

Our review was made in accordance with generally accepted government auditing standards.

As discussed with your office, due to time constraints, we did not obtain official Department of Defense comments on this report. We did, however, discuss the contents of the report with Navy officials and have considered their comments.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

A handwritten signature in cursive script that reads "Frank C. Conahan". The signature is written in dark ink and is positioned above the typed name and title.

Frank C. Conahan
Director